

III Asia Pacific D&O insurance market

BY PAULINE RENAUD

Prior to the 1990s, there was little to no demand for D&O insurance in the Asia Pacific region. This changed following the financial crisis of 1997, as privatisation expanded and foreign capital poured into Asian companies listed on foreign stock exchanges. A large number of directors and officers started seeking protection against potential claims. According to a 2006 survey conducted by Lloyd's, 63 percent of Asian directors regarded D&O as either "extremely important" or "important" to them. With the advent of the latest financial crisis, the D&O insurance market is experiencing changes once again. The increasing frequency and severity of fraud claims is driving up D&O rates and insurance premiums, while simultaneously narrowing coverage. As such, securing maximum protection is becoming increasingly difficult, as insurers attempt to reduce their risk exposure.

Class actions and their impact on the market

In Asia, regulatory action against companies has represented the bulk of D&O claims. Investigations under the Foreign Corrupt Practices Act (FCPA) by US authorities against foreign issuers on US stock exchanges have led to follow-on civil litigation, which often trigger D&O insurance claims. However, the most severe claims are arising from shareholder lawsuits. "The most significant development we have seen in the last couple of years is the number of US securities class actions against Asian, especially Chinese, companies listed on US stock exchanges," recalls Henk Bakker, underwriting manager for Asia and European D&O at HCC Global Financial Products, a subsidiary of HCC Insurance Holdings, Inc. These lawsuits tend to feature American Depositary Receipts (ADRs), in particular. He continues, "previously less developed corporate governance practices in some countries in the region have resulted in a series of securities class action claims against Chinese companies alleging non-disclosure of material information."

In 2007, seven Chinese companies faced securities class actions in the US, representing 4 percent of the total number of class actions. In 2008, five companies represented 15 percent of all class actions filed against foreign issuers in the country. Of these 12, nine had completed their IPO less than a year before the lawsuit was filed.

Outside China, the growing number of class actions has been noticeable across Asia. Recently, three US-based laws firms filed class action lawsuits against the Indian company Satyam Computer Services Ltd., on behalf of shareholders of the firm's ADRs. This followed the resignation of Satyam's chairman, Ramalinga Raju, shortly after he publicly announced his involvement in an accounting fraud. Due to the increasing legal awareness of shareholders in the Asia Pacific region and improvements in the countries' legal systems, there is likely to be more indemnification for shareholders in the coming months and years.

It has therefore become essential for companies to secure D&O insurance, and an increasing number of policies are being taken out as a result. Insurers are responding to this demand by setting up new offices, especially in Singapore and Hong Kong. However, D&O insurance is also becoming expensive, and carriers are less willing to take on risk. "Recent renewals in the Asian marketplace have seen price increases ranging from 5 percent to 50 percent, mainly for financial institutions,"

explains Aruno Rajaratnam, a managing director in the FINEX Practice, Asia at Willis Group Singapore. "There are three main reasons. First, five years of price decreases. Second, an increase in notifications of claims, particularly circumstances that might lead to future D&O incidents. Third, financial institutions' exposure has gone up and seen the biggest impact in pricing." She adds that deductibles have gone up and that some insurers, including AIG, have reduced capacity for securities claims (Side C), notably in Australia. Some underwriters are also narrowing their exposure to financial institutions by hardening D&O market rates and premiums while simultaneously reducing their limits. In addition, they are asking more questions about companies' financial statements before agreeing to provide coverage.

Such caution is also noticeable among insurance buyers, with some of them demanding that their D&O insurer should have, at least, an 'A' rating. This has been particularly the case since the liquidity crisis encountered in September and the subsequent US federal government bailouts. "The financial crisis has brought increased awareness among D&O insurance buyers of an insurer's financial strength. D&O insurance is typically a long tail business and insurance buyers are therefore looking for maximum security ratings on their D&O programs to provide maximum protection," notes Mr Bakker. In the meantime, there has been a growth in requests for higher D&O limits over the course of the last year, due to the accelerated pace of claims against directors and officers. There has also been an increase in demand for Side A policies, which provide for indemnification of individual directors and officers where the company is legally not permitted to indemnify them, particularly in insolvency situations.

In current and former Commonwealth countries, including Singapore, Hong Kong, Malaysia, Bangladesh and India, there are provisions in their individual Companies Acts, which prohibit indemnification of directors from the corporate assets if they are found guilty of wrongful acts. On the other hand, if the directors are successful in court, then there is permissible indemnity. However, fewer companies are now able to issue an indemnity letter to their directors, so directors and officers are increasingly requesting broader D&O cover. Indeed, in China, "indemnification for individuals is expected to increase as companies, and in turn more directors and officers, are held accountable for their actions and turn to their insurers for protection," points out Victor Ho, a partner at Allen & Overy LLP. "With Chinese companies accelerating their outbound investments and bringing more foreign talent into their directorial and managerial organisations, the expectation is that demand for this market will grow." Financial constraints in these difficult times, however, may be a limiting factor.

Ongoing developments

The D&O market is also continually altered by legal changes and new regulations, which is likely to continue, believes Mr Bakker. "The introduction of sophisticated corporate governance regulations all around Asia and the development of shareholder activism in some countries, together with changing regulations, have spurred demand for D&O insurance over the past few years. In the near future, we can expect an in- ▶▶

flux of new regulations on the back of the current financial crisis, which undoubtedly will have its impact on D&O insurance.” Developments in anti-competition laws, corporate governance, Company Act amendments, as well as pollution and whistleblower provisions, have already influenced insurance coverage sought by directors and officers, as they face more potential liabilities.

There are also issues connected with multinational companies, which need to ensure that their cover is adequate across all relevant jurisdictions. “The issue of non-admitted D&O policies is now a major concern with multinationals operating in Asian countries. Global D&O policies issued at the HQ country-level are only accepted in Singapore and Hong Kong. All other Asian countries require locally issued D&O policies. We now see a trend where American multinationals seem to take this requirement seriously and request local policies to be used. Most UK and European multinationals are still depending on their global covers and not opting for local D&O policies,” observes Ms Rajaratnam.

Specifically in China, the revised Companies Law of 2006 and a new Enterprise Bankruptcy Law of 2007 are both key legal developments, which impact the D&O insurance market. Directors and officers’ duties towards shareholders and lenders have been clarified, following these changes in legislation. But these duties, which include a duty of diligence and loyalty, fiduciary duty, and statutory duty, are only beginning to get tested in Chinese courts, making it difficult to assess their influence on the market. “Under the PRC Enterprise Bankruptcy Law, directors and officers are liable for civil claims if they are in breach of their fiduciary duties. In practice, we have not yet seen such an impact on D&O insurance,” says Mr Ho. “But we believe that it is only a matter of time before we see a real growth of China’s D&O insurance, as the law is put to the test and the opportunities arise for judges to apply sanctions against directors and officers.”

In other Asian countries, director duties are well known to liquidators, who step in to collect the assets of a company and set claims against it in motion before putting the business into dissolution. Therefore, a company’s board is often advised to purchase run-off cover, which remains in place after the company is no longer undertaking activities, or extended reporting period cover, which allows the insured to increase the limits of liability coverage above that of policies already purchased, as well as fill gaps in the liability coverage. With claims reporting sometimes lasting several years, directors and officers will need to be protected for the duration of that period.

Securing the right coverage

New or modified products are being sought to gain broader coverage.

Insurers are also providing several variations of the same product to suit different buyers. “There is a move in Asia to purchase Side A cover as a standalone primary or as an excess layer to sit above the normal Side A, B + C Policy. There are also queries for independent director liability cover and standalone employment practices liability insurance cover, especially in Singapore, India and Hong Kong,” explains Ms Rajaratnam. Some experts also argue that the market could see the introduction of D&O cover for liquidators, in order to protect them as they perform their role. With the financial crisis and the mounting number of insolvency cases, this nascent product may develop rapidly.

Acquiring the right D&O products is part of a broader strategy to secure the maximum and most appropriate coverage depending on the company’s profile and activities. “Besides analysing the company’s risk profile and purchasing a specific D&O policy, looking beyond what is perceived as current risk is not enough – consideration must be given to the likelihood of changes in the market,” advises Mr Ho. “When taking up D&O insurance, it is important to realise how quickly the overall Chinese environment may, and is likely to, change in respect of enforcement of directors and officers’ responsibilities.” With new legislation, tough economic times, and a changing political environment encouraging potentially more proactive PRC courts, actions taken against directors and officers are likely to grow. But such changes could occur suddenly and rapidly, and it is crucial that buyers are prepared.

In China, as well as in other Asia Pacific countries, maintaining an ongoing dialogue with the insurers, via an insurance broker, is also essential. Not only does this enable regular checking of the financial strength of the carrier, it is also vitally important in keeping the company’s risk profile up to date. A lack of disclosure between the insured and the insurer can lead to poor results. Recently, an Australian court denied directors indemnity under their D&O policy after it was proved that the company, Arimco Mining Pty Ltd, and its directors did not provide full disclosure of their financial standing to their insurers when buying the policy.

Given the current economic climate, with more companies collapsing and more claims made as a result, it is important to secure full D&O cover. This should be precisely tailored to the company’s needs, encompassing the nuances of multiple jurisdictions if necessary. Furthermore, management should strive to keep abreast of ongoing legal and regulatory changes that may affect the developing Asian D&O insurance market. This, combined with knowledge of the available products, could be vital in offsetting the company’s risk in an increasingly litigious market. ■



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